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Financial Economists, Financial Interests and Dark Corners of the Meltdown: It's Time to set Ethical Standards for the Economics Profession

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Revised November 2010

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WORKINGPAPER SERIES

Number 239

Financial Economists, Financial Interests and Dark Corners of the Meltdown: It's Time to set Ethical Standards for the Economics Profession

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November 2010

First draft: October 2010; this draft, November 18, 2010

*We are very grateful for insightful comments from James Crotty, João Paulo de Souza and Joo Yeoun Suh. They are not responsible for any remaining errors.

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Abstract: This study analyzes the conflict of interest that exists when academic financial economists, acting in their roles as presumed objective experts in the media and academia on topics, such as financial regulation, fail to report their private financial affiliations. To conduct the study, we analyze the linkages between academia, private financial institutions and public institutions of nineteen academic financial economists who are members of two groups who have put forth proposals on financial reform. In addition, we review media writings and appearances, as well as the academic papers of these economists between 2005 and 2009, to determine the portion of the time these economists identified their affiliations with private or public financial institutions when writing about or commenting on financial policy issues. Our main findings are that in the vast majority of the time, these economists did not identify these affiliations and possible conflicts of interest. In light of these and related findings we call for an economists' code of ethics which would require academic economists to identify these connections in appropriate contexts.

JEL: G01 (Financial Crises); A11 (Role of Economics; Role of Economists; Market for Economists); A13 (Relation of Economics to Social Values)
Keywords: Professional Ethics, Financial Regulation, Academic Economists, Codes of Ethics, Conflicts of Interest

1. Introduction

Academic economists often occupy roles not only in academia itself, but also in both the general media and in politics. Often they are looked to as experts in their fields. They write op-eds for newspapers, they testify on public panels, they take positions as advisors for politicians and they are interviewed by the media. Academic economists often convey the impression that they occupy these positions as independent objective experts. At the same time, some academic financial economists also consult for, serve on the boards of and even own private financial institutions. When economists serve a role as an objective expert for the media as well as a role with the private sector, there is a conflict of interest. Their objectivity may be compromised by their work in the private sector or, at least, raise questions about the possibility of bias. In this case, those relying on academic economists' assessments to help them make judgments about economic or policy issues deserve to know that such a potential bias exists. This raises the question of how often these economists declare their affiliations in the presence of a possible conflict of interest. Recently, this issue has a great deal of salience as the debate over financial reform has taken center stage and many prominent academic economists have been called on to discuss and even formally testify before Congress on financial legislation.

This study reviews the connections between academia, private financial institutions and public institutions of nineteen academic economists who are members of groups who have put forth proposals on financial reform. The majority of these are prestigious academic financial economists. Eighteen work as professors and one works in a research institute. This study reviewed media writings and appearances, as well as the academic papers of these economists between 2005 and 2009. It primarily addresses the potential conflict of interest that exists when academic economists take on dual roles as both experts in the media concerning topics such as financial regulation while also having affiliations with private financial institutions such as financial services firms, financial consulting firms, rating agencies, stock exchanges and private banks. Throughout this paper the term conflicts of interest is used solely to refer to this particular type of conflict. In this study we first identify whether this type of potential conflict of interest exists. We then look at media and academic papers to examine what portion of the time the economists declare these possible conflicts of interest in their media publications and appearances and in their academic papers. We then assess these economists' proposals for financial regulation in light of their private affiliations.

The question of financial economists' potential conflicts of interest arises in the context of the role economists' have played in the run-up to the financial crisis of 2007-2010. One widely discussed issue has been this: why did the vast majority of economists fail to foresee the financial crisis despite numerous signs all around them? There are several prominent explanations. One is that economists depended too much on abstract models that do not allow for bubbles and crisis. Another is that they were blinded by ideology. A third possibility is that economists faced a conflict of interest. In this third scenario academic financial economists, like so many others, had perverse incentives not to recognize the crisis. While determining the cause for economists' failures lies outside the scope of this paper, our paper does relate to this broader question so it is worth taking a short detour at the outset to explore it.

Paul Krugman writes about the first contributing factor, "As I see it, the economics profession went astray because economists, as a group, mistook beauty, clad in impressive-looking mathematics, for truth" (Krugman, 2009). He claims that economists were so busy with elegant models, which explained and resolved market problems perfectly, they were incapable of seeing real world messes. He continues:

> "Until the Great Depression, most economists clung to a vision of capitalism as a perfect or nearly perfect system. That vision wasn't sustainable in the face of mass unemployment, but as memories of the Depression faded, economists fell back in love with the old, idealized vision of an economy in which rational individuals interact in perfect markets, this time gussied up with fancy equations. The renewed romance with the idealized market was, to be sure, partly a response to shifting political winds, partly a response to financial incentives. But while sabbaticals at the Hoover Institution and job opportunities on Wall Street are nothing to sneeze at, the central cause of the profession's failure was the desire for an all-encompassing, intellectually elegant approach that also gave economists a chance to show off their mathematical prowess" (Krugman, 2009).

According to Krugman, this view of the economy misled economists. They did not take perverse incentives seriously, which contributed to the rise of the bubble, and thereby they failed to identify the bubble. It also led to a weakening of regulation. This occurred as belief that financial regulation is necessary lessened and consequently regulators' commitment to their jobs.

Yet relatively unexplored in the discussion so far is possible conflicts of interest as an explanation for economists' failures. These may have created perverse incentives and biased economists against recognizing the housing bubble or proposed regulations adequate to preventing another crash.

There is a well documented relationship between Wall Street, the White house and the government. Some prominent examples have received wide-spread attention: Timothy Geithner, the current Treasury Secretary, has several counselors that were receiving millions of dollars each year from Wall Street firms, such as Goldman Sachs Group Inc. and Citigroup Inc. among others. (Schmidt, 2009). Two of these aides are Lee Sachs and Gene Sperling. Lee Sachs received 3 million in salary pay as well as partnership income while working for the Mariner Investment Group. Gene Sperling made $887,727 in 2008 from Goldman Sachs as well as $158,000 in speaking fees, primarily coming from financial companies (Schmidt, 2009). Both Sachs and Sperling receive $162,900 from their job as aides for the Treasury.

Another member close to President Obama is Lawrence Summers, the Director of the White House's National Economic Council. Summers has been found to have received around $5.2 million during 2008-2009 from the hedge fund D.E. Shaw, as well as, additional money from other major financial firms, mostly in speaker's fees. He became a managing director of the D. E. Shaw group in 2006. He states that many of these speaker engagements were prior to coming onboard with President Obama, "A financial disclosure form released by the White House Friday afternoon shows that Mr. Summers made frequent appearances before Wall Street firms including J.P. Morgan, Citigroup, Goldman Sachs and Lehman Brothers. He also received

significant income from Harvard University and from investments, the form shows" (McKinnon & Farnam, 2009).

There are two issues raised by such connections. The first is whether such close and lucrative affiliations affect these economists' perspectives on important regulatory issues about which they are writing in their academic and public venues. A second issue is whether these economists identify these connections when they publish academic or media work. Summers, in fact, often did identify his private affiliation in his media pieces, which, as we will see in what follows, was not generally the case among the academic economists we study in this paper. In fact, as we show, it is quite rare for the academic financial economists in our study to identify their private affiliations even when writing directly about financial regulatory issues that might affect the private firms for which they are working.[1]

In this paper we study an important potential conflict of interest between the role academic economists take on as objective observers and interpreters for the public (for example in op-eds, news programs or testimonies) and the roles they take on for their own private interests (such as consultancies and board positions).[2] We look at this conflict of interest, not of the primarily financial business economists and their public positions, but of the *academic financial economists*. The academic financial economist faces a conflict of interest when s/he has private financial affiliations and also serves in the media as a public expert. Although, the conflict of interest between the business economist who serves public positions has been written about widely, that of the academic financial economist has received little attention. In this paper we find that academic financial economists are often not disclosing these potential conflicts of interest either publicly or academically. Moreover, these conflicts of interest could have potentially deleterious effects on economic analysis and policy reform, though we do not present sufficient evidence here to demonstrate these effects. These potential impacts shoud be the subject of further research in the future.

The core of the study assesses the links between academia, private financial institutions and public institutions of nineteen mainstream academic economists.[3] We chose the economists in our study based on their prominent position in academia and their association with a group that advocates a set of policy proposals for regulation of financial markets. The choice of these economists ensures that they will have both a media presence and a stated opinion on financial regulation. The two groups that we looked at are the Squam Lake Working Group on Financial Regulation[4] and the Financial Reform Task Force[5]. The Squam Lake Working Group on

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[1] While Summers often cites his financial affiliations in media articles, many other economists do not do this. They may argue that this information is already available via their CV or public biography. We believe that this is not enough. It is important and relevant information for the audience, few of whom will spend time searching out CVs and public biographies, and, as we argue in this paper, we believe it should be cited in their media articles and academic papers where a possible conflict of interest may emerge.
[2] The documentary movie *Inside Job* by Charles Ferguson highlights this possible conflict with graphic examples.
[3] Eighteen of whom work as professors and one who works in research institutes.
[4] Two of the members of the Squam Lake Working Group on Financial Regulation have since left the group in order to take government advisory positions but continue to be in our study. One additional member has been added who we do not include in the study. These changes took place after the empirical research for our study was completed.
[5] The Financial Reform Task Force has received support from the Pew Financial Reform Project but the Task Force states, "The Task Force recommendations reflect the views of the signatories. The Pew Charitable Trusts takes no position on any of these recommendations" (Financial Reform Task Force, 2009, p. 1).

Financial Regulation has put forth a series of papers advocating certain types of financial reform. The Financial Reform Task Force has put forth a proposal for financial reform that a subset of its members have signed onto.[6] Individuals also write their own suggestions for financial reform listed on both the Financial Reform Task Force web page and the Pew Financial Reform Project webpage.[7] In this vein, we study the relationship between these economists' private financial positions and their stance on regulation. It is important to note, of course, that this study is NOT based on a random sample of financial economists. It deals with a small subsection of financial academic economists and is therefore only suggestive of a broader problem.

Our main findings are as follows:

Academic financial economists hold many roles in the private financial sector, from serving on boards to ownership of financial services firms. Often academic economists serve as consultants for financial firms. The desire to obtain and hold a consultancy, which serves as an additional source of income, may bias these economists' views of the appropriate contours of financial regulation. A similar but stronger argument can be made for those economists that serve on boards of important and large private financial companies or who work as ongoing employees of the firm. Still other economists have founded or co-founded their own financial services firms and retain either an ownership role, a role as a chief economist or as a co-founder. It is clear that these economists might have a vested interest in the nature of financial regulation.

Many of these economists have written widely on financial regulation in the media, through their own columns and op-eds. On many occasions, we find, they have dual roles: one as an agent with a financial firm and another as an "economics expert" in the media. This raises the following question: to what degree do academic financial economists self report their private affiliations? This is particularly important when they write on an issue that could embody a conflict of interest. This would be the case, for example, when they discuss the regulation of derivatives in the media while working for a firm that sells derivatives all the while neglecting to report this affiliation to the media. We found that very rarely did these economists self report their private financial affiliations. Instead, they mainly cited themselves as academics or by prestigious public positions, such as with the Federal Reserve or IMF.

This norm changes when we come to business news centered on investment advice, such as reported on Bloomberg.com. Here economists are cited first by their financial affiliations and second for their academic achievements. Occasionally, economists working for a financial firm will write investment advice or opinions for these firms' media outlet or website. In these cases they are usually cited as working for the firm first and as an academic second. Thus, in the specialized instances where economists write in business outlets, there are exceptions to the general case. Thus, when these economists are writing for the general media they are most often cited as an academic and when writing for a more specialized audience they are cited for their

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[6] For the Squam Lake Working Group on financial Regulation see http://www.cfr.org/project/1404/squam_lake_working_group_on_financial_regulation.html and for the Financial Reform Task Force see http://www.financialreformtaskforce.org/ .

[7] Again, for these individual project reports, the Pew Financial Reform Project states, "This note does not necessarily represent the views of the Pew Financial Reform Project."

work in that realm. Most of the economists in our study did not write investment advice except as a duty for firms they worked for.

We also observed if these economists identified financial affiliations in their academic papers. Again, in principle, their financial affiliations could be a source of bias in their academic work similar to the argument concerning bias in the media. In academic papers, in all but two cases, the financial affiliations of the authors were never mentioned.

In order to test the hypothesis that these economists can be influenced by the conflicts of interest encompassed by their dual roles we attempted to measure the strength of their proposed regulations and compared this index with whether these economists worked for private financial firms. The index is explained in depth in section six.

Lastly, we looked at what effect the economic crisis has had on these economists' opinions on financial regulation. The financial crisis can be, in part, attributed to the deregulation of the financial markets (Bernanke, 2010) which economists have had an important hand in promoting. This position was supported by asserting that financial markets are inherently stable and therefore policy makers had the tools necessary to promote continued stability and growth without significant financial market regulation. These claims have been proven wrong by the financial crisis. This brings up the question: Has the financial crisis influenced a change in opinion of academic financial economists concerning their recommendations for regulation before and after the crisis? We attempt to answer this question by looking at the recommendations of each of the economists in our study both before and after the financial crisis. We find that some, but far from all of these economists, changed their minds on the need for stricter financial regulation following the crisis.

2. Academic Economists' Affiliations with Private Financial Institutions

In order to evaluate the extent of the affiliations between the financial academic economists and the private sector we began with two groups of economists that were prominent in the field of financial economics and which had taken a public stance on financial regulation: the Squam Lake Working Group on Financial Regulation and the Financial Reform Task Force. We then attempted to detect what, if any, affiliations the academic economists associated with these groups had with private financial institutions. We then looked only at those positions which were relevant to the financial sector. Private banks, hedge funds and mutual funds are all categorized as financial services firms. We created five categories of financial affiliations: financial services firm, stock exchange, financial consulting firm, credit rating agency, and research arm of financial and advocacy firm.

We commenced our search by looking through these economists' curriculum vitae (CV's) and continued the search through media archives. This search seemed fairly effective at locating owners, founders or cofounders, and members of boards of private financial institutions. Identifying consultancies, on the other hand, presented a more difficult problem. If a consultancy is listed in the CV or if the company lists the academic as a consultant then these can

be discovered. If neither the economist nor the company mentions these affiliations, then we may not have been able to find it.

Accordingly, our study most likely under-represents the linkages between these academics and the private financial sphere.

Nonetheless, we found extensive affiliations between financial academic economists and the private sector. Well more than half of the economists we looked at served with private financial institutions and in many cases they occupied quite prominent positions. The depth of the marriage between the academic economists and the private financial institutions varies by economist. In many cases we found that the economists worked with more than one financial firm with six economists having worked for two or more financial companies.

In addition to looking at the affiliations of these economists with private financial firms, we also looked at their affiliations with prestigious domestic and international public organizations that make policy or give advice with respect to financial matters. These include the Federal Reserve, the International Monetary Fund, and other such organizations. We report on those results in section 4.

2.1 Results

More specifically, of the nineteen economists that we included in our study, we found that thirteen, or almost 70%, worked in some capacity with private financial institutions. In our sample, two of the financial academic economists are co-founders of private financial services firms where they work in key positions, one as managing partner and the other as chief economist (See Table 1). In the case of the former, the firm is owned by all the managing partners, making the former an owner of the firm. In the case of the latter, we were unable to determine ownership. A third economist works for two banks, in one case as president and in the other as director. Eight of the financial academic economists serve on the board of directors of private financial firms and two economists were identified as consultants or affiliated experts for private financial firms. Since it is difficult to identify consultancies unless either the company or the economist mentions it, it is likely that more than two economists served as consultants.

The fact that well over half the economists we evaluated have positions with private financial firms shows how commonplace it is. The question arises: how often and in what contexts do these financial economists reveal their connections to these private firms?

Table 1: Private Financial Affiliations

Economists	Private Financial Affiliation	Position
Economist 1	Financial Services Firm; Financial Services Firm; Financial Consultancy Firm	Vice Chairman; Board of Directors; Chairman of Advisory Board
Economist 2	Financial Services Firm	Chairman of Board
Economist 3	Financial Services Firm; Financial Services Firm	Trustee to the Board; Advisory Board Member

Table 1: Private Financial Affiliations (continued)		
Economists	**Private Financial Affiliation**	**Position**
Economist 4	Financial Services Firm	Board of Directors of Stock, Bond and Balanced funds
Economist 5	Financial Services Firm; Research arm of Financial Consultancy & Advocacy Firm	Board of Directors; Senior Advisor
Economist 6	Stock Exchange	Board of Directors
Economist 7	Financial Services Firm; Financial Consultancy Firm	Founding, Managing Partner; Affiliated Expert
Economist 8		None
Economist 9		None
Economist 10	Credit Ratings Agency; Financial Services Firm	Board of Directors; Trustee, Director; Consultant to other Financial Services Firms
Economist 11	Financial Services Firm	Board of Directors
Economist 12		None
Economist 13		None
Economist 14		None
Economist 15	Financial Consultancy Firm*	Affiliated Expert
Economist 16	Financial Services Firm	Chief Economist and Co-founder
Economist 17		None
Economist 18	Research arm of Financial Consultancy & Advocacy Firm	Academic Advisor; Consultant to Various Others
Economist 19	Financial Services Firm; Financial Services Firm; Financial Services Firm	President; Director; Advisory Committee

Sources and Methods: See Appendix C

Notes: *Since this economist works for only a financial consultancy firm, his case is not as clear cut an example. We include him because this is a private consulting firm that deals with financial consultancy among other types of consultancy to corporations, law firms and governments.

Column 1 refers to the number of private financial affiliations the economist has. Column 2 is the position the economist has in each of the private financial affiliations. For example, Economist 1 works for three separate financial services firms, and one financial consultancy position. In one he holds the position of vice chairman and in another he is on the board of directors; in the last he is the chairman of the advisory board.

2.2 How did economists identify themselves in their writings?

To answer this question we reviewed both general media and academic publications, evaluating how the economists identified themselves in both domains. We emphasized identification in the media because it is here that policy pieces directed at influencing public opinion appear and thus, where the clearest potential conflict of interest occurs. The study is limited to evaluating only economists' affiliations with private financial institutions and reviewing if the economists identify these affiliations either in their general media articles,

interviews and testimony, or in their academic papers. Of course, for those economists who do not work in the private sector this issue is not applicable.

We first looked at how economists defined themselves. We then examined in what portion of their writings these economists self identified with private financial institutions. In the case of the media, we looked primarily at their articles, such as op-eds, as well as reviewing relevant interviews and testimonies. We also evaluated a subset of their academic papers. We assessed media articles from January of 2005 through October of 2009 for each economist. We identified the quantity of articles for each person and of the number of times in which he acknowledged a relationship to the financial sector. We followed the same process with the academic papers. Lastly, we tried to create an aggregate statistic representing the times in which the economist identified himself in both media and academic publications.

The results are presented below in table 2. The first column in the table shows how the economists identified themselves in their academic publications. The most common identification was with their academic position, labeled professor, and inclusion as a member of NBER (National Bureau for Economic Research), and occasionally by prestigious appointments in public and international institutions. If they identified with a private financial firm, making transparent a conflict of interest, it appears in the table even if they only identified it once. In column two we present the proportion of times these economists identified their private financial affiliations in their academic papers. Since almost all the economists are financial economists their views on financial regulation will have some degree of relevance to their academic work.

As column two shows, we found that these economists rarely identified themselves as working in the private sphere. Only Economist Seven and Economist Sixteen identified their private financial affiliations in academic publications. In the case of Economist Seven, the paper in which he identifies his private financial affiliations uses research put together by himself and some colleagues from the financial firm he works with. Of all the economists in our study, Economist Sixteen most regularly identifies his private financial affiliation. He is a co-founder of his own firm and frequently writes academic articles in support of a new financial product produced by his firm. In all other cases, the authors did not mention their positions in private financial firms.

The third column shows the percentage of media articles, interviews and testimonies in which the economists cite themselves as having affiliations with private financial institutions. Again, we find that economists most often identify themselves with their academic position and rarely with their roles in private financial institutions. This occurs even when they are proposing policies concerning the regulation of financial markets. The total number of media articles, interviews and testimonies we sampled for each person is the denominator in the fourth column. It varies as each of these individuals both writes and appears a differing amount in the general media. In addition to the problem we faced of sifting through media of a prolific author, we also encountered the opposite case; the problem of when an author writes very little. It is plausible to expect these economists to write on financial regulation as all the economists in our study belong to groups proposing a set of financial reform. We attempted to get a representative sample of media articles and appearances for each person over the period of 2005 to 2009, but it is certain

that we did not review all media articles, interviews and testimony for all economists. Some economists have (at least recently) written little for the general media.

In the case of media articles, interviews and testimonies, we found that most of the economists did not identify themselves with the private financial institutions they had affiliations with. Of the thirteen economists with ties to the private financial world, eight of them did not acknowledge these ties in any of the general media articles, interviews and testimonies reviewed. This means that a very significant portion of the economists did not recognize any affiliation or possible conflicts of interest when identifying themselves in the general media. The remaining four that did recognize an affiliation did so to differing degrees. Two were quite transparent, identifying this connection almost half to all of the time; Economist Eleven and Economist Sixteen. We will see that the case of Economist Eleven is an outlier. Economist Sixteen reported affiliations to a private financial firm 48% of the time. The other two were more reluctant, reporting affiliations to private financial firms only 14 to 17% of the time.

Economist Seven, although he writes specific investment advice papers on behalf of the firm, does not write general media articles. In fact, his only media articles are investment advice papers targeted toward the financial investors in the firm. As an author for the firm he is identified first and foremost with that firm, but these articles are not targeted to the general media and do not touch on policy issues. Consequently, we excluded these from the media articles reviewed. As a result, we mark this case as non-applicable (NA). Economist Six has not written any media articles or given interviews and testimony, to the best of our knowledge over the time period reviewed, so again we report this case as NA.

In the case of Economist Eleven, who also writes for a private financial firm, we include these in the sample of articles because he does touch on policy issues concerning the government's role in financial markets and regulation in these writings. Given that he rarely writes general media articles, we are left with those written for the audience of the private financial firm. Of course, in these he is identified with the firm one hundred percent of the time. This makes him an outlier and results in the 100% value for identification of private financial firm affiliations. By contrast, in his academic articles he never identifies himself with the private financial firm.

The fourth column is the aggregate measure of how often these economists identified their affiliations to private financial firms in media articles, interviews, testimonies and academic publications. The total number of sources reviewed is the denominator. T he frequency with which the economists identify private financial affiliations in the media and academic publications varies from 0% to 71%. Here we see that eight out of thirteen never revealed financial firms affiliation over the 2005-2009 period in the papers and articles we covered.

It is reasonable to think that the media bears some responsibility here and should inquire as to whether the economist has private affiliations when interviewing him or her. But, rarely did the media take on the role of identifying these economists with their private financial institutions in order to qualify or alert readers to conflicts of interest. Thus, if the economists do not take on this ethical imperative there is little chance the media will take it up either.

Table 2: Identification in Academia and in the General Media

Economists	Primary Identification in Academic Papers	Percent of time economists identified affiliations with private financial institutions in academic papers	Percent of time economists identified affiliations with private financial institutions in the media	Percent of time economists identified affiliations with private financial institutions in both media and academia
Economist 1	Professor	0/10 = 0%	4/23=17%	4/33 = 12%
Economist 2	Professor, NBER	0/10 = 0%	0/18 = 0%	0/38 = 0%
Economist 3	Professor	0/5 = 0%	0/6 = 0%	0/11 = 0%
Economist 4	Professor	0/6 = 0%	0/21 = 0%	0/27 = 0%
Economist 5	Research Institutes	0/7 = 0%	0/18 = 0%	0/25 = 0%
Economist 6*	Professor, NBER	0/11 = 0%	0	0/11 = 0%
Economist 7	Professor, NBER	1/17 = 6%	0	1/17 = 6%
Economist 8	Professor, NBER, Financial Firm	0/6 = NA	0/10 = NA	NA
Economist 9	Professor, NBER	0/8 = NA	0/7 = NA	NA
Economist 10	Professor	0/20 = 0%	1/7 = 14%	1/27 = 4%
Economist 11	Professor	0/10 = 0%	25/25 = 100%	25/35 = 71%
Economist 12	Professor, NBER	0/6 = NA	0/20 = NA	NA
Economist 13	Professor, NBER	0/8 = NA	0/18 = NA	NA
Economist 14	Professor, NBER, IMF	0/5 = NA	0/4 = NA	NA
Economist 15*	Professor, NBER	0/3 = 0%	0/8 = 0%	0/11 = 0%
Economist 16	Professor, Private Financial Firm	2/7 = 29%	16/33 = 48%	18/40 = 45%
Economist 17	Professor	0/12 = NA	0/6 = NA	NA
Economist 18*	Professor, NBER	0/5 = 0%	0/7 = 0%	0/12 = 0%
Economist 19	Professor, NBER, ECGI	0/19 = 0%	0/1 = 0%	0/20=0%

Sources and Methods: See Appendix C

Notes: NA denotes not applicable in cases where the economist has no private financial affiliations. Those entries that are zero signify that the economist had no media appearances. The fourth column is a combined statistic of columns 2 and 3.

(*)The asterisk signifies that we could not identify these economists with private financial affiliations over the entire period of 2005-2009. In these cases we used a subset of papers and media articles, interviews and testimonies from the years that we could identify affiliations with private financial institutions. This is approximate to the year not to the month and day.

The first column describes the most frequent way the economist defined himself in academic papers and media appearances. The second column is the number of times the economists identified themselves as working in the private sector divided by the total number of academic papers reviewed for each economist. Thus for economist 1, 0/10 signifies that the economist identified himself as working in the private financial sector in 0 of 10 academic papers, i.e., in all papers he identified solely with his academic or public position (as referred to in column one). The third column is the number of times the economists identified themselves as working in the private sector divided by total number of media articles, interviews and testimonies reviewed for each economist. Thus for economist 1, 3/23 signifies that in 3 of 23 media appearances the economist identified himself with the private financial sector and in the other 20 he only identified with his academic or public position (as referred to in column one).

2.3 Anecdotal example of a conflict of interest

Our sample, small as it is, suggests that there may be a norm within the academic economics profession for financial economists to primarily identify themselves with their academic role in both the media and academic publication. This is the case even when they hold simultaneous positions with private financial institutions. We have also established in the previous section that these multiple roles allow the possibility for conflicts of interest to occur. In this section we present an example to illustrate the kind of potential conflict we have in mind.

A clear example of this conflict of interest can be found in a webcast of a panel of economists on the financial crisis in April of 2009 at Stanford University (see Appendix B for partial transcript and link). The video available does not include the whole panel discussion but does include the complete Q&A period where the panel took questions from the audience. One of the panel members and a Stanford financial economist was Darrell Duffie. He had recently been appointed to the Moody's Corporation board of governors in October, 2008. During the Q&A session Duffie identifies himself from the outset with his academic appointment at Stanford and does not initially reveal his position on the board of Moody's. His dual position as an objective expert on the crisis on a public panel of a highly reputable university as well as his position on the board of Moody's Corporation is an example of the conflict of interest present between his roles. The conflict of interest materializes over the course of the Q&A period as his role as an objective expert and as a Moody's' board member conflict, when asked questions about regulation of credit ratings agencies.

He takes two questions related to the crisis, the second of which is directly related to ratings agencies, without acknowledging his role for Moody's. It is only on the third question where the questioner explicitly asks whether ratings agencies have a conflict of interest (in that they are paid by the companies they rate) that Duffie reveals he is on the board of Moody's. This anecdote illustrates what we found to be true of most financial economists in our study. They are quite reluctant to disclose their private sector affiliations even in the event of a possible conflict of interest.

How does this conflict of interest influence his position on the role of ratings agencies in the crisis and what types of reform may be necessary? Although it is difficult to separate cause and effect, we can look at what he states his position on ratings agencies to be, as well as, his opinion on whether ratings agencies should be reformed to eliminate these conflicts of interest.

Duffie maintains that although the ratings agencies did have a conflict of interest, in that they were hired by the same companies they were supposed to rate, this did not cause the rating of risky securities AAA. Rather, this was the result of the ratings agencies making a mistake based on inadequate models that depended too much on historical data. He says in response to a question,

> "Do I believe that those conflicts of interest were responsible for the triple A ratings which were mistakes? No, in answer to the question earlier, I'm pretty confident that they just blew it. That they had no idea that the whole structure of the housing market and the mortgage origination market had gone wrong and they didn't include scenarios that allowed

> for that because they were over reliant on past data. That's not to say they didn't make a mistake. They made a big mistake but I don't think the mistake was because of a conflict of interest."

He acknowledges that there is a conflict of interest for the ratings agencies and that the ratings agencies understand that there needs to be further investigation of the problems to find a way to eliminate the conflict of interest. Yet he claims to believe that it did not in any way contribute to their faulty ratings.

Furthermore, when he opines on how to prevent this problem Duffie is unable to prescribe anything other than the status quo. He says, "None of the other models that have been proposed to avoid conflicts of interest have been found to have less conflict of interest or result in even reasonable ratings." One of the options that had been put forward was a public option, whereby the government would pay the ratings agencies.

Obviously, he seems to be quite sympathetic to the ratings agencies, defending them to the public based on his role as an academic, not as a Moody's board member. If he faced the public, defending ratings agencies as a Moody's' board member, the reception of his statements would be taken under a much different light. This example, perhaps extreme, perhaps not, is critical to understanding the potential conflict of interest such economists face.

3. Financial Affiliation and Financial Regulation: The Financial Reform Index (FRI)

The Duffie example is suggestive but, of course, just one instance. We looked at our sample of economists to see whether these economists' private affiliations might have influenced their pronouncements or positions on financial reform. To do this we first created an index of financial reform, our *Financial Reform Index (FRI).* Using the *FRI* we compared the economists based on the strength of their calls for financial regulation by reviewing their opinions and proposals on financial regulation.

The *Financial Reform Index (FRI)* was created by looking at a range of proposals for the regulation of financial markets put forward by many economists and analysts during the financial reform debate. We evaluated a variety of proposals, such as that put out by Paul Volcker and the Group of Thirty, as well as proposals by progressive groups, such as the Economists' Committee for Stable, Accountable, Fair and Efficient Financial Reform (SAFER)[8] (Group of Thirty, 2009, SAFER). We also became very familiar with the proposals put forward by the economists in our study. Finally, we looked at the proposals developed by the Obama Administration and promulgated by Treasury Secretary Timothy Geithner (US Department of the Treasury, 2009). This gave us a breadth of views that allowed us to create a scale of increasing degree to which private choices of financial firms are constrained and the degree to which regulatory agencies are subject to democratic political norms.

[8] Gerald Epstein is a coordinator of SAFER. "SAFER presents the views of economists and analysts on financial regulation and reform. Our goal is to broaden perspectives on financial regulation in order to inform the public debate and influence policy making" (SAFER 2010). http://www.peri.umass.edu/safer/

The index is cumulative so that the more aspects of reform an economist publicly agreed with, the higher that economists' index number. It is divided into nested and non-nested components. An example of a nested component is as follows. One proposal is to reduce perverse and asymmetric incentives in the financial system including the suggestion of a voluntary say on pay by boards of directors. The stronger version of this is to reduce perverse and asymmetric incentives in the financial system by enforcing mandatory rules on compensation. An economist that agreed with the latter is also categorized as agreeing with the former. The non-nested components stand alone and do not alter those that precede them. The cumulative nature of the index means a higher percentage of the total index represents a stricter stance on regulation (See Appendix A for a description of the Financial Reform Index (FRI)).[9]

In creating the index score for each economist, we relied mainly on media articles, interviews, testimonies and academic papers. Academic papers for many financial economists can be quite technical, which makes media articles, interviews and testimonies a better source for policy proposals of financial regulation. We also looked at the stances advocated through the papers and proposals put forth by each group calling for financial reform that the economist belongs to.

The review of economists' writings allowed us to come up with a set of recommendations and opinions on financial regulation held by each economist as well as for the group that they are associated with. We evaluated these opinions by looking at around twenty articles over the period of 2005 through 2009, if they wrote fewer articles than twenty in the time period we then turned to the academic papers they had written in this period. If they wrote very little and neither media writing and appearances nor academic papers amounted to twenty pieces over that period then the sample for that person was smaller. We assumed that this time frame and quantity was adequate for their writings to reveal if they supported financial regulation or not. It is certain that not all media interviews, op-eds, columns and academic papers were reviewed, but we covered a large enough sample as to be representative in most cases. Since some academics write very little for the media and primarily write technical papers where the topic of regulation is not relevant we may not have reviewed a large enough sample of these economists' writing to have a clear view of their stance on financial regulation. If this is so, it is documented and presented with the findings.

We then took the economists' recommendations for financial regulation and compared them to the index we created to see what the strength of their recommendations are. All of the economists we looked at were members of two larger groups calling for financial reform, the Squam Lake Working Group on Financial Regulation and the Financial Reform Task Force**.** The Squam Lake Working Group on Financial Regulation has a series of proposals proposed publicly with consensus. Not all the members of the Financial Reform Task Force have endorsed a single set of policies although a subgroup has signed onto a group proposal.

Since seventeen of the economists in our study belong to a group of economists that have signed on to a set of proposals for financial regulation, they tend to have similar stances on regulation. This makes it quite difficult to distinguish differences of opinion and in extension,

[9] Of course, we do not argue here that a higher index number (i.e., more restrictions) necessarily make for better regulation. In this paper, this index is created for comparison purposes only.

differences in the strength of their calls for regulation. In order to circumvent this problem we looked at both their individual and their group calls for regulation. Limiting the review of recommendations to those that each economist has taken individually can generate a sense of their particular opinions on financial regulation. It is natural that the group ranking would be greater than the individual ranking, as each economist brings to the table what is most important to him or her and this is molded into the group proposal. Thus, we have a group, an individual ranking, and the aggregate group and individual ranking. Their individual ranking, as well as the group ranking, are used only to compare the range of views the economists hold. We understand that the most complete representation of each economist's views comes from the combination of what they have called for individually and as part of a group.

Looking at Table 3 we see that the opinions as measured by our index ranges from 0% to 36%. This range is slightly greater than if we include both their individual and group calls for financial reform. In this case, they measure from 8% to 36% (see table 3). To put this in context, when we evaluated the control group, SAFER, they measured 92% on the index (Crotty & Epstein, Avoiding a Financial Meltdown, 2009) (SAFER). Two other groups, the Squam Lake Working Group on Financial Regulation and the Financial Reform Task Force, measured 28% and 32% respectively. The Squam Lake Working Group on Financial Regulation and the Financial Reform Task Force, as well as, the individual economists reviewed, called for a fairly limited set of financial reforms.

We hoped to answer the question of whether these economists' positions with private financial institutions affect the extent of their calls for financial reform. We conjectured that the stronger the economists' alliance with the private sector the weaker would be their calls for regulation. A problem we encountered was the little variation on financial reform calls among the economists in our study. This is indicated by the range of only 0-36% mentioned above. Moreover, the small size of our sample renders impossible any rigorous test of this hypothesis. In any case, it is difficult from or data to tell if there is a significant difference in the extent of regulation called for between those with links to private financial institutions and those without.

Looking down the rows, Table 3 is organized beginning with the group of economists with connections to private financial institutions and ending with those without. The average of the calls for financial reform as a percent of the index for those economists with a measured connection to the private sector, including their group position is 29%. If we exclude their group position and look only at their individual calls for regulation then the average is 12%. The average of the calls for financial reform as a percent of the index for economists, including their group position, without connections to the private financial sphere is 30%. When we exclude their group position the individual average is 12%. Thus, the views of these two groups as measured by the index are virtually identical.

Table 3: Financial Affiliation and Strength of Calls for Regulation (Financial Reform Index)

Economists	Private Financial Institutions	Position	Index of Individual Position	Index of Group Position	Index of Individual and Group Position
Economist 1	Financial Services Firm; Financial Services Firm; Financial Consultancy Firm	Vice Chairman; Board of Directors; Chairman of Advisory Board	36%	NA*	36%
Economist 2	Financial Services Firm	Chairman of Board	24%	32%	36%
Economist 3	Financial Services Firm; Financial Services Firm	Trustee to the board; Advisory board member	8%	32%	32%
Economist 4	Financial Services Firm	Board of directors of Stock; bond and balanced funds	8%	NA*	8%
Economist 5	Financial Services Firm; Research arm of Financial Consultancy & Advocacy Firm	Board of Directors; Senior Advisor	32%	36%	36%
Economist 6	Stock Exchange	Board of Directors	0%	28%	28%
Economist 7	Financial Services Firm; Financial Consultancy Firm	Founding, managing partner; Affiliated Expert	0%	28%	28%
Economist 10	Credit Ratings Agency; Financial Services Firm	Board of Directors; Trustee, Director	8%	28%	28%
Economist 11	Financial Services Firm	Board of Directors	12%	28%	32%
Economist 15	Financial Consultancy Firm	Affiliated Expert	16%	28%	28%
Economist 16	Financial Services Firm	Chief Economist and co-founder	8%	28%	28%
Economist 18	Research arm of Financial Consultancy & Advocacy Firm	Academic advisor; Consultant to various others	0%	28%	28%
Economist 19	Financial Services Firm; Financial Services Firm; Financial Services Firm	President; Director; Advisory Committee	8%	28%	28%
Economist 8	None	None	4%	28%	32%
Economist 9	None	None	0%	28%	28%
Economist 12	None	None	8%	28%	28%
Economist 13	None	None	16%	28%	32%
Economist 14	None	None	16%	28%	28%
Economist 17	None	None	28%	28%	32%

Sources and Methods: see Appendix C

Notes: *NA signifies those economists that have not signed onto a group proposal for financial reform but do belong to the group. One economist belongs to both groups and thus his group rating is a combination of the two group proposals.

(notes to Table 3, continued) The Financial Reform Index is a measure of financial reform that attempts to measure the strength of calls for reform (see appendix A). The index of the individual position refers to where a single economist falls on the index. For example, Economist 1 calls for 36% of reforms on the index. The index of group position indicates where the group proposal the economist has signed onto to falls on the index. The index of individual and group position refers to the measure of the individual person's calls for financial reform on the index plus any additional calls for reform advocated by the group proposals they have signed onto.

4. Affiliations with Public Entities and International Organizations

The economists we included in our study not only have connections to private financial firm, they are also connected to public entities and international organizations. Many of the economists work for central banks both within and outside of the United States, for international institutions, such as the International Monetary Fund (IMF) and the World Bank (WB), as well as occupying government positions in the US and abroad.

In recent years, these institutions have, for the most part, promoted widespread financial de-regulation. As a result, one would expect that these institutions would both attract and screen for economists who tended to support these de-regulatory views. From the perspective of the economists themselves, being associated with these important "public institutions" can enhance their credibility, and prestige and can also be lucrative in terms of consulting fees, travel and research support and in terms of access to data and inside information. As such, there is likely to be a symbiotic relationship between these institutions and those financial economists who tend to promote shared views.

For these reasons, there may be similar concerns about potential conflicts of interest that are present in the private sphere. Central banks, in particular, have a vested interest in the outcome of the debate over financial regulation, as not only will they be affected by the regulation they may very well be implementing parts of the regulation. Moreover, in recent years, central banks have been among the institutions promoting financial de-regulation, which have also been consistent with the views of many in the financial sector.

International institutions, especially the IMF and to some extent the WB, have also shown themselves to be strong adherents of neo-liberal policies in developing countries over the past twenty years regardless of their success. The approach of minimal governmental interference, as advanced by some international institutions, would certainly not be compatible with proposals of more extensive regulation of the financial markets in developing countries. Economists that hoped to or did work with these institutions may have been biased toward minimal regulation.

It is interesting to mine the connections between economists' positions in the private and public spheres and their recommendations for regulation. However it is difficult to differentiate these influences from those stemming from ideological or theoretical norms. The economists we look at both attended and work in the premier academic institutions in the United States**.** There is a tremendous amount of socialization in graduate schools concerning the way in which people model and conceptualize problems. The standard views or models are often accepted as best. Holding these views is often like holding a golden ticket that allows access to the best clubs and journals. This has created a professional norm to which many academic economists ascribe,

creating a cultural aversion to regulation within economics. Thus, the ideological bent can be difficult to separate from individual positions on regulation possibly influenced by their connections to the private sector.

Table 4 shows the economists and what kinds of public positions they hold categorized by central banks, international institutions and government positions. We considered any jobs held between 2006 and 2009 as relevant and included them. We choose to extend the period of consideration beyond those positions presently held, as economists seem to move in and out of public sector jobs more frequently than is the standard in the private sector. To catch this fluidity of engagement we extend the period of observations to three years. In table 4, we do not include economists who have held positions farther back than 2006. We do include those economists who cite such a position without giving a date but we denote such occurrences. We exclude all economists that have not held positions farther back than 2006 or economists for which dates are unknown in our calculations. A significant portion, eight of nineteen (42%) of the economists we looked at, currently hold positions or have held positions in such entities over the period 2006 to 2009. During that period we find that six economists have been or are currently working with the Federal Reserve, two have been or are currently working with international institutions and one has been or is currently working in a government position. This number increases substantially if we include the total past history of the economists in our study. In this case, we find that fourteen of the nineteen (74%) economists have at some point held a position in one of these entities.

Many of the academic economists in our study occupy positions in both public and international institutions. Although this is not the main focus of our paper, it is useful to recognize that public sector, government and positions in international institutions could cause a similar bias as that which we found with regards to the private financial institutions. If this is true, then it may be ethically necessary to disclose these positions as well as those in private financial firms. We find voluntary disclosure to be much more common in this case than in that of private financial firms, particularly for media as opposed to academic papers. This is especially true with regards to prestigious positions, as it gives economists further credentials and weight in the public eye.

Table 4: Public and International Institution Affiliations

Economists	Central Banks	International Institutions	Government
Economist 1	Panel member, Federal Reserve Bank of NY;	Bank for International Settlements; Member, Bretton Woods Committee;	None
Economist 2	None	None	None
Economist 3	None	None	None
Economist 4	None	None	None
Economist 5	None	None	None
Economist 6	Consultant, Federal Reserve Board of Governors*	Consultant, World Bank*	None

Table 4: Public and International Institution Affiliations, continued			
Economists	**Central Banks**	**International Institutions**	**Government**
Economist 7	None	None	None
Economist 8	None	None	None
Economist 9	Academic Consultant, Federal Reserve board;	None	None
Economist 10	Financial Advisory Roundtable, Federal Reserve Bank of NY;	None	None
Economist 11	None	None	None
Economist 12	Economic Advisory Panel, Federal Reserve Bank of NY; Bank of Finland;	None	None
Economist 13	Board of governors, Federal Reserve;	None	None
Economist 14	Consultant, Federal Reserve Board*	Chief economist, IMF; Consultant, World Bank	Consultant, Indian Finance Ministry*
Economist 15	None	None	None
Economist 16	None	None	None
Economist 17	Federal Reserve Bank of NY	None	None
Economist 18	None	None	Member, Council of Economic Advisors Executive Office of the President
Economist 19	Consultant, Federal Reserve Bank of NY*	Consultant, WB*; Consultant, IMF*	None

Sources and Methods: See Appendix C

Notes: * denotes dates positions held are unknown and we were unable to confirm dates. These positions are listed by economist and are included for interest only. We do not include these in our calculations.

6 of 19 economists or 32% work with a Central Bank, Government Agency or an International Institution. For example, Economist 1 is a panel member of the Federal Reserve Bank of NY, works with the Bretton Woods Committee and holds no government position.

5. Comparison between Private and Public Affiliations

The academic financial economists in our study often hold positions in the private sphere, work for public entities, or for international organizations; and occasionally they work in a combination of these. Table 5 below compares the two categories of economists in our study. We find that many of these economists hold more than one job. While holding a prestigious academic job, they may also work in the private financial sector, with public entities or international organizations. Table 5 depicts the evident flexibility of moving from academic to public to private sector work for these elite economists. It is plain that the purely academic financial economist in our survey is a rare species indeed.

From table 5 we can see that only one economist of nineteen holds a solely academic job. Furthermore, we find that at least three occupy roles in both the private and public sectors, including for international organizations. If we included in the table historical experience beyond

the last three years, of the economists' public positions or positions for international institutions, we would find that the number of purely academic economists would fall from one to zero.

Table 5: Public Private Sector Comparison

Economists	Private Financial Institutions	Public Institutions
Economist 1	Financial Services Firm; Financial Consultancy Firm	Central Banks, International Institutions
Economist 2	Financial Services Firm	None
Economist 3	Financial Services Firm (x2)	None
Economist 4	Financial Services Firm	None
Economist 5	Financial Services Firm; Research Arm of Financial Consultancy &Advocacy Firm	None
Economist 6	Stock Exchange	None
Economist 7	Financial Services Firm; Financial Consultancy Firm	None
Economist 8	None	None
Economist 9	None	Central Bank
Economist 10	Credit Ratings Agency; Financial Services Firm	Central Bank
Economist 11	Financial Services Firm	None
Economist 12	None	Central Bank
Economist 13	None	Central Bank
Economist 14	None	International Institution
Economist 15	Financial Consultancy Firm	None
Economist 16	Financial Services Firm	None
Economist 17	None	Central Bank
Economist 18	Research Arm of Financial Consultancy & Advocacy Firm	Government
Economist 19	Private Bank (x3)	None

Source and Methods: see Appendix C

Notes: 13 of 19 economists (or 68%) work with private financial firms. 8 of 19 economists (or 42%) work with public institutions. 3 of 19 economists (or 16%) work with both a private financial firm and a public institution. 18 of 19 economists (or 95%) work with either a private financial firm or a public institution or both.

x2 and x3 mean that they are affiliated with two or three financial services firms respectively. For example Economist 1 is affiliated with two different financial services firms, one Financial Consultancy Firm and also holds or has recently held a central bank position and an international institution position.

5.1 Comparison of public and private affiliations and financial regulation

The economists in our study are quite similar in the level of financial regulation they propose, creating a difficulty in deducing what effect private financial affiliations might have on economists' calls for regulation. This brings up the question, what influence other roles that these economists have, outside their academic jobs, may have on the types of financial reform

they call for. These could be jobs for central banks, government positions and international institutions. It is possible that there is a pervasive ideology in economics spanning prestigious positions in the Federal Reserve, government and international institutions that is similar to that of those economists working in private financial institutions. In order to deduce whether opinions regarding financial regulation differ between economists occupying these positions and those in the private financial sector we compare the strength of regulation called for between the two. We denominate as "public institutions" all Federal Reserve positions, government positions and international institution positions.

The table below is organized by the economist's affiliation. The first rows are economists that only have affiliations with central banks, the government or international institutions. The next group has affiliations with both the public and private sector. Following theses are economists with only private sector affiliations. Last we have one economist who has no private or public sector affiliation. We then look at the difference between those who work in the purely public sector and those who only work in the private sector.

We find little difference in the range of their calls for regulation based on these two categories. If we take the average of those working solely with public institutions, including their group position, an average of 30% and looking at their individual position, we find an average of 14%. When we turn to the private sector we find an average of 28% for those economists who work solely in the private sector, including their group position. Individually, we find an average of 12%. There is a slightly higher call for regulation from those in the purely public sector but it is minimal. We exclude those who work with both private and public sectors. It is important to recognize that consultancies are difficult to identify and so, there may be more overlap between the two groups than what is recognized here.

Table 6: Comparison of Economists' Calls for Regulation Depending on Private or Public Institution

Economists	Private Financial Institutions	Public Institutions	Index of Individual Position	Index of Group Position	Index of Individual and Group Position
Economist 9		Central Bank	0%	28%	28%
Economist 12		Central Bank	8%	28%	28%
Economist 13		Central Bank	16%	28%	32%
Economist 14		International Institution	16%	28%	28%
Economist 17		Central Bank	28%	28%	32%
Economist 1	Financial Services Firm; Financial Services Firm; Financial Consultancy Firm	Central Bank; International Institutions	36%	NA*	36%
Economist 10	Credit Ratings Agency; Financial Services Firm	Central Bank	8%	28%	28%
Economist 18	Research arm of Financial Consultancy & Advocacy Firm	Government	0%	28%	28%

Table 6: Comparison of Economists' Calls for Regulation Depending on Private or Public Institution (continued)					
Economists	**Private Financial Institutions**	**Public Institutions**	**Index of Individual Position**	**Index of Group Position**	**Index of individual and group position**
Economist 19	Financial Services Firm; Financial Services Firm; Financial Services Firm		8%	28%	28%
Economist 2	Financial Services Firm		24%	32%	36%
Economist 3	Financial Services Firm; Financial Services Firm		8%	32%	32%
Economist 4	Financial Services Firm		8%	NA*	8%
Economist 5	Financial Services Firm; Research arm of Financial Consultancy & Advocacy Firm		32%	36%	36%
Economist 7	Financial Services Firm; Financial Consultancy Firm		0%	28%	28%
Economist 11	Financial Services Firm		12%	28%	32%
Economist 15	Financial Consultancy Firm		16%	28%	28%
Economist 16	Financial Services Firm		8%	28%	28%
Economist 6	Stock Exchange		0%	28%	28%
Economist 8			4%	28%	32%

Sources and Methods: see Appendix C

Notes: The index is a measure of financial reform that attempts to measure the strength of calls for reform (see appendix A).

*NA denotes those persons who belong to a financial reform group but who do not sign onto the group proposals. One economist belongs to both groups and thus his group rating is a combination of the two group proposals.

The index of individual and group position refers to the measure of the individual person's calls for financial reform on the index plus any additional calls for reform advocated by the group they belong to. The index of the individual position refers to where a single economist falls on the index.

Average of index of individual + group position of those working only with public institutions is 30% compared to 28%, the average of index of individual + group position of those working only with private institutions. Average of index of only individual position of those working with public institutions is 14% compared with 12%, the average of index of individual position of those working only with private institutions.

6. Financial Reform Proposals and the Evolution of Economists' Views on Financial Reform, After the Crisis

In the sample of economists considered, many did not write about regulation prior to the financial crisis. In fact, one of our primary ways of judging whether or not their views on financial reform changed was to compare whether they wrote about financial reform before and after the crisis. The nine economists we categorized as having changed their minds had not written about financial reform, in the time period we evaluated prior to the crisis. In addition,

another three economists do not write about financial reform independently either before or after the financial crisis.[10]

The recent financial crisis gravely threatened the stability, not only, of the United States economy, but also of the world economy. The crisis is a clear indicator of problems present in the financial sector. These problems were not recognized by much of the economics profession prior to the financial crisis. Many mainstream academic financial economists did not question the increasing leverage and underlying insecurity of the financial sector, relying instead on the institutions and practices of the New Financial Architecture (NFA) (Crotty, Structural causes of the global financial crisis: a critical assessment of the 'new financial archeticture', 2009). The NFA integrates minimal regulation with complex financial instruments and government bailouts, assuming that unhindered capital markets correctly price securities and distribute risk to those best able to handle it, minimizing that risk in financial markets (Crotty, Structural causes of the global financial crisis: a critical assessment of the 'new financial archeticture', 2009). The recent turmoil exposed the many fallacies of the NFA. This includes the instability of new and complex financial instruments that achieved a prominent role in the financial infrastructure, as well as the instability caused by the progressive dismantling of financial regulation over the past thirty to forty years. It would seem plausible that after the breakdown of the financial sector in this past crisis, mainstream economists would recognize these serious problems and advocate change. Yet, the current financial crisis is not without precedent, as Volcker notes, there have been "… at least five serious breakdowns of systemic significance in the past 25 years" (Volcker, 2008). Though there was apparent instability of financial markets over this time period, many economists continued to support increasing deregulation and the development of more complex financial instruments. Therefore, there is precedent for economists to continue as before with little change to their opinion or to the profession.

We assessed whether the economists we reviewed changed their minds before and after the crisis with respect to financial reform. To study this, we compiled their opinions on financial reform and compared them before and after the financial crisis. We looked at media articles, interviews and testimonies from 2005 through 2009, reading twenty articles over that period if available, prioritizing those that addressed financial reform. If they had not written many media articles or given testimony and interviews then after exhausting the media sources we moved onto academic papers. Using a period of five years seemed sufficient to it indicate whether their opinions and policy proposals regarding financial regulation had changed. In some cases the economists did not have media appearances and their academic publications were highly technical, with little room for a discussion of financial reform. These cases are marked with an asterisk in our table denoting that there was sparse material for comparison. It is important to note that our searches were not all inclusive and we did not track down all possible media and academic works, but we expect that the range we used has given us a representative sample.

If pre-crisis they did not propose regulatory policies and post crisis they did then we classified them as having changed their minds concerning financial regulation. In cases where they did write about financial reform both before and after the financial crisis we compared those writings to understand it there was a change in opinion. Lastly, if they did not write about financial reform either before or after the financial crisis but had written a significant quantity of

[10] Of course they have joined groups calling for financial reform and signed onto the proposals the groups have issued.

media articles thus having the opportunity to address financial reform if they so wished, we classified them as not having changed their opinions concerning financial reform. Two of the economists, although they have joined groups calling for financial reform, do not actually specialize in the field of financial economics. Since their media and academic articles reflect other areas of expertise, it is difficult to get a sense of a change in their perspective on financial regulation. These economists are marked with a caret.

We can see from our table 8 below, that of the nineteen economists we evaluated nine have changed their opinions according to our criteria with regards to financial reform after the financial crisis. This is almost half of the economists in our study. If one excludes the four economists whose views could not be evaluated, then 9 out of 15, or 60% changed their minds on regulation after the crisis.

Is that a lot or a little? In view of the severity of the crisis and the role of financial regulation (or the lack there of in precipitating it), 60% seems remarkably low to us. Perhaps more striking, though, is the lack of attention these economists paid to financial regulation before the crisis itself.

Table 7: Comparison of Reform Attitudes Before and After the Financial Crisis

Economists	Change from Before to After the Crisis	Economists	Change from Before to After the Crisis
Economist 1	Yes	Economist 11	No*
Economist 2	No	Economist 12	Yes
Economist 3	No	Economist 13	No
Economist 4	Yes	Economist 14	Yes
Economist 5	Yes	Economist 15	Yes
Economist 6	No^	Economist 16	No
Economist 7	No*	Economist 17	No
Economist 8	No	Economist 18	No^
Economist 9	No	Economist 19	Yes
Economist 10	Yes		

Note: * denotes economists who did not write media articles and whose academic publications were very technical. In this case the economist did not address financial reform and we do not have enough information to compare them before and after the crisis.

^ denotes economists who are not financial economists although they have joined groups calling for financial reform. Since their media articles and academic publications do not address financial reform we do not have enough information to compare them before and after the crisis.

Nine of 19 economists, or 47%, changed their ideas concerning financial regulation. Excluding economists whose views could not be discerned 9 out of 15 or 60% changed their views.

7. Dark Corners and Financial Economists' Conflicts of Interest: What Should be Done?

Economics is unusual among the professions in that it does not have a code of ethics providing guidelines to navigate possible conflicts of interest. As DeMartino writes, "…...virtually all other professions that matured during the same era [early 20th century] adopted at least a code of conduct, and some adopted a full-blown body of professional ethics" (DeMartino, 2010, p. 67). Codes of ethics have been put in place in fields such as journalism, even business, management and consulting. Anthropology and sociology are both relevant academic fields that have codes of ethics. As we have argued here, economics is not immune to conflicts of interest. In the context of this paper we can see how useful a code of ethics would be, especially for academics, many of whom have to navigate the difficulties of combining several roles- in particular the tension between the role as an objective academic expert and as a private financial operative.

The American Economic Association (AEA), formed in 1885, represents the economics profession in the United States. It has never adopted a code of ethics although there were many questions concerning the issue to the AEA's secretary in the 1930s.

> "Needless to say, the AEA had no such code [of ethics], nor had the officers any sanctions or means of enforcement, and the executive committee, when pressed, viewed the investigation of such matters as beyond the range of its proper functions. Of course, some matters of professional behavior could not be ignored, but whenever possible these were dealt with on an individual basis, without involving the executive committee or the membership at large" (Coats, 1985, p. 1710).

The reasons why the AEA has never developed a code of ethics, when so many other professions have, are unclear. Coats attributes it to the possibility that the subject was too partisan for the AEA to take a stance on (Coats, 1985, p. 1718).

As noted above, most other professions have adopted codes of ethics. For example, the Society of Professional Journalists developed a code of ethics that dictates that journalists should report to the public and maintain their ability to act independently, "Remain free of associations and activities that may compromise integrity or damage credibility" (Society of Professional Journalists). The Center for Independent Media states in their code of ethics, "Avoid conflicts of interest, real or perceived, and disclose unavoidable conflicts" (The New Journalist Code of Ethics). The Media Alliance code of ethics says "Disclose conflicts of interest that affect, or could be seen to affect the accuracy, fairness or independence of your journalism. Do not improperly use a journalistic position for personal gain" (Media Alliance Online). In all cases, it is first recommended to avoid conflicts of interest and if it is unavoidable, to disclose them.

In the wake of the financial scandals of the early 2000's, it became popular for business schools to put forth codes of ethics. Although this practice's popularity waned through the mid decade it has picked up again following the recent financial crisis. For example, in 2009 a group of motivated students at the Harvard business school created an oath they describe as follows, "The oath is a voluntary pledge for graduating MBAs and current MBAs to 'create value responsibly and ethically'" (The MBA Oath). More than half of the 2009 MBA graduating class

at Harvard signed the oath. It became popular not only at Harvard but also with MBA's around the US and the world when the oath went viral. It has garnered more than 800 signatures from 115 countries (VanderMey, 2009).

Many management and consulting firms have also put forth codes of ethics that specify how to contend with conflicts of interests. The Association of Management Consulting Firms writes, "We will immediately acknowledge any influences on our objectivity to our clients and will offer to withdraw from a consulting engagement when our objectivity or integrity may be impaired" (Association of Management Consulting Firms). The Institute of Management Consultants USA writes, "I will avoid conflicts of interest or the appearance of such and will immediately disclose to the client circumstances or interests that I believe may influence my judgment or objectivity" (Institute of Management Consultants USA).

Universities also have guidelines on how their employees and faculty should deal with conflicts of interest. Several of the professors in our study work at the University of Chicago and at Dartmouth College. Therefore, it will be instructive to look to these universities guidelines for dealing with conflicts of interest, as well as, our home university- The University of Massachusetts Amherst.

The University of Chicago policy looks at conflicts of interest where the outside interest of the employee/faculty member may come into conflict with the wellbeing of the university.

> "An individual conflict of interest is thereby generated. Involvement with, or financial interest in, professional or commercial activities outside the university should not compromise the fulfillment of a faculty member's obligations to the University. Such outside activities conflict with obligation to the University when they involve excessive commitments of time; that is they generate a conflict of commitment. … These activities also conflict with obligations to the University when they bias the nature and direction of scholarly research, or when they influence a faculty member's decision or behavior with respect to teaching and student affairs, appointments and promotions of faculty or other matters of interest to the University. Sensitivity to these potential conflicts of interest is especially important when a faculty member has a substantial involvement in commercial enterprises related to that faculty member's research or when the faulty member is engaged in prolonged and intensive consultancies" (The University of Chicago, 2007).

In this case, faculty members are responsible for disclosing to the university any of their financial activities that there may be reason to believe that it will affect their teaching, research or other activities performed on behalf of the university.

Dartmouth College's policy on conflicts of interest is that if any employee of the college including a faculty member has "..a significant financial, personal or professional interest that could potentially create a conflict of interest or the perception of one in any transaction involving the college they must disclose this in writing to the relevant dean of the college" (Dartmouth College, 2009). Significant financial interests include salary or consulting fees of over 10,000, also included are equity interests of over 10,000, or more than 5% ownership in any entity.

University of Massachusetts Amherst policy states that employees must disclose any significant or substantial financial interests that could represent an actual or potential conflict of interest between individual interests and those of the university or the reasonable appearance of such to the public. Outside activities are defined as "Non-academic activities undertaken by a Faculty Member in his or her area of expertise in association with individuals or entities outside the University. Such activities include for example, working as an employee or a consultant, or serving as an executive, trustee or director for a company or non-profit organization." (The University of Massachusetts Amherst & Boston, 1997). If these outside activities represent a significant financial interest, defined as equity of more than 1% in a company owned by the employee or their family or compensation of over 10,000 in the past year, the individual must disclose the conflict of interest.

The economists that follow the university guidelines are looking at conflicts of interest specifically between the economist's private affiliations that comprise their work with the university. What we are examining in this paper is conflicts not just between the university and the private sector loyalties but between that of public expert and affiliations with the private financial sector. It is important that the public be aware of any conflicts of interest that the economists face when they give counsel on such subjects as financial reform. One important step forward would be to disclose one's private financial affiliations in all public policy pieces, particularly those where the economist is "framed" as an objective academic expert.

Those conflicts of interest that the academic economist might not be limited to those between the university and the other job but could well be between the private job and their role as public expert. Furthermore, even when these conflicts of interest are reported to the university it does not signify that they are reported to the public. Thus, university conflict of interest codes, although important for the university, do not alleviate the problem academic economists face who occupy a concurrent role in the private sector and as a public expert.

The American Sociological Association on the other hand recognizes that the sociologist has a responsibility to the public. It puts forth in its Code of Ethics in the section dealing with conflicts of interest, "Sociologists maintain the highest degree of integrity in their professional work and avoid conflicts of interest and the appearance of conflict" (American Sociological Association, 1999, p. 7). Later they go on to say, "Sociologists disclose relevant sources of financial support and relevant personal or professional relationships that may have the appearance or potential for a conflict of interest to an employer or client, to the sponsors of their professional work, **or in public speeches and writing**" (American Sociological Association, 1999, p. 7 (emphasis added)). This is interesting because it takes the issue from the mostly private realm of a researcher's conflicts of interests into the public realm of the academic expert. In this code of ethics the sociologist is accountable to the public.

It seems apparent that a first step for economists is to create and adhere to a code of ethics. The language of the American Sociological Association's code of ethics would be a good place to start. In the context of this paper, the code of ethics would prescribe that economists list their private affiliations in any appearance for the media or the government when there is a conflict of interest or the appearance of a conflict of interest. For example, if an economist were to write an op-ed they should describe themselves not only as a professor but also as a board

member, an owner and/or a consultant. These roles should also be reported when testifying in government positions or being interviewed by the media.

8. Conclusion

In this study, we showed that the great majority of two groups of prominent academic financial economists did not disclose their private financial affiliation even when writing pieces on financial reform. This presents a potential conflict of interest. If this pattern prevailed among academic financial economists more broadly this, in our view, would represent an even greater social problem. Academic economists serve as experts in the media, molding public opinion. They are also important players in government policy. If those that are creating the culture around financial regulation as well as influencing policy at the government level for financial reform also have a significant, if hidden, conflict of interest, our public is not likely to be well-served.

We also explored what quantitative effects these conflicts of interest may have on the strength of the calls for regulation by these economists. We found that it was very difficult to make a quantitative argument. There seems to be little difference between those "prominent", academic financial economists with private financial affiliations and those without with. There are many reasons why this could be the case. First, there may be a similar overarching ideology prevalent in mainstream economics concerning the virtues of the free market. Second, it could be that central banks, governments and international institutions prefer to employ economists with a similar outlook on regulation as those chosen by private institutions. Since only one of the economists in our study is not employed by either a private financial institution or public institution we would not be able to identify variation on this score. Third, there is the possibility that the lines between academic financial economists and private financial affiliations may be much more fluid than we captured due to the difficulties of locating consultancies.

Our study could be improved in several ways. First, it would be beneficial to have a larger sample of economists. Second, a random selection of economists – if the sample were large enough - would allow us to undertake a richer and broadly more representative examination of these issues. Such a study, however, would also involve a considerable expenditure of resources and is beyond the scope of the present study. For example, for the study to be comprehensive, we would need to be able to locate other private financial connections which we have not been able to identify here, for example payments for lectures, testimony, research papers and expert witnessing. Including these, if possible, would also lead to the comprehensiveness, as well as the expense, of this project.

Based on the findings of these studies and broader considerations, we believe that the economics profession, which does not have a code of ethics, should create such a code and delineate appropriate action for economists in the event of conflicts of interest of the type described in this paper. Even in absence of such a code, economists should voluntarily disclose potential conflicts of interest in media articles and academic papers. In addition, news/media/non-profit outlets, including those hosting "financial reform groups", should insist that economists reveal these identifications in relevant situations.

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Appendix A

The Financial Reform Index (FRI)

This index was created by looking at a range of financial reform proposals, including those of the Financial Reform Task Force, the Group of Thirty, The Squam Lake Working Group on Financial Regulation and SAFER, as well as the proposals tabled by the Obama Administration. The FRI is cumulative so that the larger the number of proposals agreed to by the economist, the stricter is the regulation with which the economist publicly agrees. (Of course, we cannot argue here that stricter is necessarily better.) The **FRI** is then calculated as a ratio of the total number of regulations as a share of the total in the list. Nested signifies that if an economist advocates statement two of our index s/he is also counted as advocating statement one. When nested proposals occur they are confined under each heading; they do not extend beyond the heading and they are always ordered in increasing strictness. Thus, if they are nested the higher number will include the lower number but not vice versa. Not nested are those proposals for regulation that stand independently.

Systemic Regulator

1. Promote a systemic regulator.
2. Promote a systemic regulator - not the Federal Reserve.

- Nested

Regulating Systemic Risk

3. Impose countercyclical macro-prudential regulations such as countercyclical liquidity and capital requirements (not about limiting size).
4. Limit systemic risk in the financial system by increasing capital and liquidity requirements at all times.

- Not nested

5. Limit systemic risk by reducing the over-all degree of leverage in the system (market based solutions - not capital and liquidity requirements).
6. Limit systemic risk by reducing the over-all degree of leverage in the system (not capital and liquidity requirements) through regulatory based restrictions.

- Nested

7. Reduce complexity of financial institutions by limiting the range of activities they engage in (Reconstitute a Glass Steagall in that regard - this would limit size).

- Not nested

What is included in Regulation

8. Broaden the regulatory framework to include **some** financial actors, markets and products, especially those that are systemically important or risky.

9. Broaden the regulatory framework to include **all** financial actors, markets and products, especially those that are systemically import or risky.

- nested

Regulation of Securities

10. Limit some securities to being traded or sold on markets but allow others to be traded OTC.

11. All securities have to be traded or sold on markets.

- Nested

Perverse incentives

12. Reduce perverse and asymmetric incentives in the financial system. (includes applying voluntary, nonbinding resolutions like say on pay resolutions).

13. Reduce perverse and asymmetric incentives in the financial system by enforcing mandatory rules on compensation.

- Nested

Conflicts of Interest

14. Reduce conflicts of interest, fraud and corruption by strengthening oversight and enforcement and/or limit outsourcing of regulatory responsibilities to private institutions.

15. Reduce conflicts of interest, fraud and corruption by strengthening oversight and enforcement by using public entities such as public credit ratings.

- Nested

Too Big to Fail

16. Improve financial resolution mechanisms.

17. Reconstitute a more efficient, productive and stable financial system by limiting the ability of individual institutions to become too big, complex and interdependent to fail, by breaking firms up or re-imposing Glass-Steagall type regulations.

18. Stop institutions from becoming too big, complex and interdependent to fail by taxing un-productive financial activities.

- Not nested

Consumer Protection

19. Protect consumers and investors by imposing market based solutions that discourage excessive risk taking (such as, non-binding transparent standards of safety, reducing information asymmetries, increasing consumer awareness of financial markets, tax and subsidy policies to change incentives from high leverage risky forms of financing to others).

20. In order to protect consumers and investors regulate financial products that are risky.

21. In order to protect consumers and investors ban financial products that are too dangerous and/or lacking in economic benefits.

- Nested

Accountability and Democracy

22. Increase the transparency of financial and regulatory institutions and markets.

23. Make financiers pay for financial meltdown not only by improving financial resolution mechanisms but do this by shifting the burden of financing these to the owners, managers and major creditors of financial institutions through a financial transactions tax or by levying fees.

24. Work to stop the regulatory race to the bottom that results from regulatory arbitrage at the international level as the competition for jobs and income in their financial sectors by some jurisdictions undermines the ability of others to enforce regulatory rules and standards in their own financial markets.

25. Ensure that current decisions about financial reform and ongoing decisions about financial structure and regulation are made in the public interest rather than shaped by the narrow interests of financial institutions and their lobbyists. This accountability and democratization of the financial regulatory mechanism can be gained by greatly reducing the amount of money in legislation through measures like citizens on boards of directors and campaign finance reform

- Not nested

Appendix B

Link to the Stanford Panel on the Economic Crisis

http://www.youtube.com/watch?v=OSBgfYrL9fs

Transcript to some of the Q&A's from the Stanford Panel "Unchartered Territory: Panel on the Economic Crisis" Stanford Academic Council at the Stanford Graduate School on April 30th 2009 Duffie cited as professor.[11]

11: 48 (Unidentified person) Question: I have a question about going forward. Wasn't a contributor to this greed on the part on the people in power in financial institutions, like banks and hedge funds and so on, who took risks because it was in their interests, because they got big bonuses if they made money? Don't we need some kind of legislative or regulatory control that prevents human greed on the parts of small numbers of individuals from putting the economy for the rest of us at this kind of risk?

12:21 (Duffie) Answer: OK, so, there is a certain human nature to reach for more whenever its available. Yes, as an organization, the big financial banks were greedy. Now, what does that mean at the level of individuals? It meant that the risk management systems were not eliminating that greediness and risk taking, it meant that the compensation contracts in some cases encouraged the risk taking because it paid you this year if you made a profit this year rather than waiting to see whether that was a real profit.

But I tend not to make this a kind of personal thing about greed, I tend to think about it in terms of, again contracts, risk management systems, educating management particularly the boards and CEOs about what sorts of things are going on inside their banks and if that's done well then the organization won't behave as though it looks like a greed center, but rather, that its providing a service to the economy.

13:50 (Unidentified person) Question: My question is: How was it possible for these CDOs to be rated AAA? How is it possible to use some sort of equation that says these things are correlated when they're not possibly correlated? Could you just explain, would this be regarded as no risk?

14:08 (Duffie) Answer: Okay so the simplest answer is they made a mistake. And one slightly simpler explanation is the fact that they didn't include in their analysis a scenario by which the housing market goes down 30%. Almost every risk management outfit; banks, hedge funds, Fannie Mae, Freddie Mac and the ratings agencies were putting their worst scenario for the housing market at either no price change or a 2 or 3 or 4 or 5% price decline as the worst case scenario. No one had it in mind that house prices would go down as they did. So, basically it

[11] Transcribed by Jessica Carrick-Hagenbarth.

was a mistake based on relying on historical data rather than thinking about whether the economy was on a sustainable path.

25:20 (Unidentified person) Question: Question to the panel: coming back to the AAA rated CDOs and other securities, you may be being a little to kind to the rating agencies and the bank underwriting people who issued securities that they immediately passed on to other people, paid the rating agencies to rate them, paid the people who sold them commissions, paid the executives and banks big commissions. There seems to have been systematic incentives that caused people who have conflicts of interest to systematically overrate these securities. They were issuing money to people that they didn't verify income and so on. Is it really just an inability to predict that housing prices would go down or were there some fundamental conflicts of interest in that system?

26:06 (moderator) Darrell being a brave man said I'll take that question.

26: 09 (Duffie) Answer: Braver than you think because I've just joined the board of the Moody's corporation which is one of the top ratings agencies. *[Laughter by people on the panel.]* So, conflicts of interest in ratings and underwriting, speaking for the rating agencies, which are most accused of this conflict or interest, there is a conflict of interest, the rating agencies or at least Moody's is very up front about this fact- that there is an inherent conflict of interest when someone is paying you to rate something that they are issuing. None of the other models that have been proposed to avoid conflicts of interest have been found to have less conflict of interest or result in even reasonable ratings. In fact, the SEC had a meeting two weeks ago in which there was four panels, none of whom could come up with a scheme that seemed to have even a reasonable agreement that would have less conflict of interest or produce reasonable ratings. One example would be a public utility model by which the government would simply collect money from all bond issuers, including collateralized debt obligation issuers, and then give it equally to all ratings agencies for rating those CDOs. And I don't know, we teach in economics that incentives matter and if you're going to get paid for something no matter how well you do it then the quality of the work might not be very good. Do I believe that those conflicts of interest were responsible for the triple A ratings which were mistakes? No, in answer to the question earlier, I'm pretty confident that they just blew it. That they had no idea that the whole structure of the housing market and the mortgage origination market had gone wrong and they didn't include scenarios that allowed for that because they were over reliant on past data. That's not to say they didn't make a mistake. They made a big mistake but I don't think the mistake was because of a conflict of interest.

Appendix C

Sources and Methodology

We identified the academic financial economists in the two groups calling for financial reform; the Squam Lake Working Group on Financial Regulation and the Financial Reform Project. All except one of the economists work for universities, the exception works for a research institution. We searched through the economists' publications, both academic and media; looking at those posted and available on the internet, through the database lexis nexus academic or through their own CVs and affiliated web pages. We primarily considered the years from 2005 through 2009. We first established if the economist was affiliated with a private financial institution. These affiliations were located in various ways. We found affiliations through press releases by firms, where the firm identified the economist as an expert, owner or board member. The other most common way we found private financial affiliations was when the economist listed working with the firm in their CV. Since many economists do not list all of their consultancies and many firms do not list all of their consultants it is reasonable to assume that the economists have more connections to the private financial sector than we were able to locate. In each publication reviewed we looked at how the economist identified himself as well as any proposals for financial regulation. Aggregating this information we constructed the tables.